216364

Shell Chemicals

April 26, 2006

The Honorable W. Douglas Buttrey
Chairman, Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423-0001

Dear Mr. Buttrey:

Pursuant to our Notice of Intent dated April 20, Shell Chemical LP submits the following written comments in advance of the hearing scheduled for May 11, 2006 on STB Ex Parte NO. 661: Rail Fuel Surcharges.

Shell Chemical LP is an affiliated entity of Shell Oil Company, the US affiliate of Royal Dutch Shell plc. Shell has extensive operations in the United States. Its organizations explore, develop, produce, purchase, transport and market crude oil and natural gas. They also purchase, manufacture, transport and market oil, motor fuel and chemical products and provide technical and business services. Shell Chemical LP manufactures a variety of bulk products such as olefins, aromatics, solvents, ethylene oxide/glycols, to name several. Manufacturing facilities are operated in Texas, Louisiana (2), and Alabama. An affiliated facility in the province of Alberta, Canada is also affected by rail fuel surcharges in the US. Our products are shipped by both negotiated rates and tariff rates. Because chemical products manufactured by Shell are predominantly "base" or "intermediate" chemicals our customers are most often other manufacturers that supply products that are present in virtually every aspect of our daily lives. Our ability to deliver products to our customers cost-effectively impacts the cost our customers must charge for their products in their variety of consumer and business end uses.

Shell Chemical LP believes that base freight rates whether by increases in tariffs or negotiated rates, achieve full recovery for the cost of fuel when the tariffs or rates are first set. This is one of the reasons we conclude that existing railroad fuel surcharge programs provide a measure of over-recovery to the rail industry. This over-recovery is magnified for shippers of commodities that are shipped at base freight rates that are higher than freight rates for commodities that are of lesser value per unit of weight or volume. With a program based upon a percentage of the freight rate, and not actual fuel consumption or miles traveled, shippers such as Shell Chemical LP are paying in excess of the actual fuel costs for each shipment. Under the percent of freight rate methodology, chemical shippers in particular pay a disproportionate amount of fuel surcharge.

As a way of demonstrating the over-recovery, we analyzed the ratio of fuel surcharge recovered over actual fuel costs for two of the rail transportation providers. Using railroad methodology, Shell Chemical LP reviewed numerous routings on two rail carriers and found the following on fuel surcharge recovery.

- Carrier 1 – The fuel recovery ranged from 54% to 2,161%. The average recovery was 285%.
- Carrier 2 – The fuel recovery ranged from 55% to 577%. The average recovery was 143%.

In short, our analysis shows that on average the surcharges recover more of the cost of fuel than is actually consumed. The above data is based on 2005 costs. As base rates continue to escalate as they are expected to do, the problems with the existing fuel surcharge programs will only worsen.

It is Shell Chemical LP's view that base freight rates should cover all fixed and variable costs, including fuel, and margin. Surcharges should only provide a recovery mechanism for the incremental increase in fuel from its base cost period. It should never allow for price increases that do not relate directly to the cost of fuel actually consumed in the transportation of commodities under the tariff or negotiated rate. There may be valid reasons for differing freight rates for transportation of different commodities over the same distance and route. The logic applied to base freight rates does not apply, however, to subsequent adjustments to recover the increase in the cost of fuel consumed.

Over the past 24 months, Shell Chemical LP has re-indexed its fuel surcharge programs for both truck and barge carriers (this was a collaborative effort and based on fuel consumption). This was done to recognize the change in the energy markets since 2002 and to take into account changes to the base rate (of which fuel is a component) that have transpired since. We also recognized that the fuel surcharge formulas were not linear and thus required some adjustment over time. For pipelines, of which Shell Chemical LP is a large user, energy consumption is not a separate item in each carrier's tariff, although energy is consumed in operation of pumps and other equipment necessary for pipeline transportation. The Federal Energy Regulatory Commission only allows an annual adjustment for all cost increases based on the Producer Price Index for Finished Goods. The adjustment for the next 12 months will be approximately 6% on July 1, 2006.

Shell Chemical LP suggests that the rail fuel surcharge programs need to be redesigned to take the following into account:

- The programs need to be based on fuel consumption, not a percent of the freight rates (e.g. it requires the same amount of fuel to move 80 tons of chemicals as it does 80 tons of gravel the same distance).
- The appropriate energy index must be chosen to track changes in actual fuel costs. Changes in West Texas Intermediate Crude (WTI) or on-highway diesel

are not good short-term indicators for railroad fuel costs. The Association of American Railroads' (AAR) monthly fuel index would be a good candidate.

- While freight rates and other mechanisms evolve year to year, the fuel surcharge curves should be revisited on a more timely basis to eliminate curves that are no longer appropriate (e.g. 2002 curves are in continued use although they have an accelerated slopes from fuel costs that are unlikely to be seen again in the near term).
- Surcharges must follow the model of "incremental" cost recovery for the fuel costs which are not reflected in base rates and not cost "over-recovery" for that provides for increases in margin or recovery of other costs.

In summary, Shell Chemical LP recognizes that the cost of fuel is an important element of cost in the operation of a railroad, and we do not oppose carriers' needs for protection from increases to fuel that would make operation of their business unsustainable. However, the existing rail fuel surcharges should be examined closely and redesigned to meet this aim. As we determined with other modes of transportation, fuel surcharge formulas require periodic adjustment to meet business needs.

We appreciate the opportunity to provide comments to the Surface Transportation Board on this matter and look forward to the constructive dialogue that ensues.

Sincerely,

Joseph V. Kelly

Joseph V. Kelly
Global Category Manager – Rail Transportation
Contracting & Procurement
Shell Downstream, Inc.
On behalf of Shell Chemical LP